No. 01-463

IN THE

Supreme Court of the United States

UNITED STATES OF AMERICA,
Petitioner,

v.

FIOR D'ITALIA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF *AMICUS CURIAE* OF THE NATIONAL RESTAURANT ASSOCIATION IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Petitioner states that the question for review is whether the employer's share of the Federal Insurance Contribution Act (FICA) tax on employee tip income must be determined by accumulating the result of individual audits of individual employees or may instead be based on a reasonable estimate of the aggregate amount of tips received by all employees.

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BRIEF *AMICUS CURIAE* OF THE NATIONAL RESTAURANT ASSOCIATION IN SUPPORT OF RESPONDENT

STATEMENT OF INTEREST OF *AMICUS CURIAE*

The National Restaurant Association ("NRA") is the largest trade association representing restaurants in the United States.[1] Membership in the NRA includes some 52,000 foodservice establishments, with over 254,000 restaurant units. The restaurant industry employs an estimated 11.6 million workers, making it the largest private-sector employer

[1] Both Petitioner and Respondent have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus curiae* made a monetary contribution to the preparation or submission of this brief.

in the United States. *2002 National Restaurant Association Restaurant Industry Pocket Factbook* (hereafter "*2002 Restaurant Industry Factbook*").

Government statistical data and/or National Restaurant Association research surveys indicate the following facts about the restaurant industry that may assist the Court with respect to issues being examined in this case:

- There are over 2.4 million directly tipped employees in the restaurant industry (waitstaff and bartenders) and over a half million indirectly tipped employees (buspersons, hosts/hostesses, chefs or cooks, dishwashers, etc.). *U.S. Department of Labor, Bureau of Statistics* (2000).
- Tipped employees at over 14% of all fullservice (tableservice) restaurants participate in tip pools, whereby directly tipped employees share their tips with indirectly tipped employees. *National Restaurant Association Legislative Issues Survey* (1999) (hereafter "*NRA Legislative Survey*").
- 89% of all fullservice (tableservice) restaurants are independently owned and operated, while 11% are owned and operated by chain restaurants. *1997 Economic Census*, U.S. Bureau of the Census.
- 99% of all fullservice (tableservice) restaurants are small businesses as defined by the U.S. Small Business Administration, i.e. foodservice and drinking establishments with annual sales under $5 million. *1997 Economic Census*, U.S. Bureau of the Census.
- 98% of all foodservice and drinking establishments have fewer than 100 employees. *1997 Economic Census*, U.S. Bureau of the Census.

- 58% of all fullservice restaurants have under $500,000 gross annual income; 21% have gross annual income between half and one million dollars; and 20% are between $1.0 – 4.9 million. *1997 Economic Census*, U.S. Bureau of the Census.
- 10% of all fullservice (tableservice) restaurants have been audited by the IRS based on the amount of tips reported. *NRA Legislative Survey.*
- 12% of restaurants file their tax returns under the "Alternative Minimum Tax" (AMT) provision of the Internal Revenue Code (IRC). *NRA Legislative Survey.*
- Fullservice (tableservice) restaurants operate on average at a 4 to 5% profit margin each year. *2001 [National Restaurant Association] Restaurant Industry Operations Report.*

SUMMARY OF ARGUMENT

The Government's interpretation that the Federal Insurance Contribution Act (FICA) permits the IRS to assess a FICA tax on restaurant employers based on an estimate of the aggregate amount of tips the IRS believes were received by all of the restaurant's employees is neither authorized by Congress nor a rational approach as applied to the restaurant industry.

ARGUMENT

I. NEITHER THE STATUTE NOR THE LEGISLATIVE HISTORY AUTHORIZES AN EMPLOYER FICA TAX ASSESSMENT BASED ON AN AGGREGATE ESTIMATE OF UNREPORTED TIPS.

The Government argues that Congress permitted the IRS to impose on restaurant employers a FICA tax on tips the IRS

estimates were not reported by all employees as a group rather than determining on an individual basis who underreported tips and the amount. *Amicus curiae*, the National Restaurant Association ("NRA"), believes that this approach is not statutorily authorized and disregards the clear intent of Congress.

Congress stated in 26 U.S.C. 3101(a) that there is imposed "on the income of every *individual*" a tax equal to certain specified wage percentages. (Emphasis added). In 26 U.S.C. 3121(a) Congress excluded from the definition of "wages" for the FICA tax imposed by sections 3101(a) and 3111(a) remuneration (tips) "paid to *an individual*" in excess of the contribution and benefit base (the annual wage limitation). Congress provided in 26 U.S.C. 3121(q) that "tips received by *an employee* in the course of his [or her] employment shall be considered remuneration for such employment." (Emphasis added).

These statutory sections clearly indicate that Congress intended that an *individual-by-individual determination* must be made as to tip income, including the tips *each employee* failed to report before it is appropriate to make a FICA tax assessment. There is no indication, explicit or implicit, that Congress allowed the IRS to *disregard the individual determination approach* and permit determinations to be made on the basis of an aggregate estimate for all employees. Statutory provisions that are clear and unambiguous on their face should not be disregarded by the agency directed to enforce the Congressional mandate. *See, e.g., Jay v. Boyd*, 351 U.S. 345 (1956).

While *Amicus* believes that this should end the matter and result in dismissal of the Government's petition, *cf., Chevron U.S.A. v. Natural Res. Def. Council*, 467 U.S. 837, 842 (1984), the legislative history of IRC 3121(q), while sparse, further reflects Congressional intent that an *individual-by-individual determination* is required. Congress predicated the

statutory amendments imposing a FICA tax on all tips in 1987 on the basis that such tips be credited to *each employee's* social security account. The Senate Committee Report to the 1987 enactments, S. Print No. 63, at 203 (1987), 133 Cong. Rec. 534, 826 (1987), states in relevant part:

> in order to apportion the costs of social security benefits more accurately, employers should be subject to [FICA] tax on all tips *which are credited for benefit purposes*. (Emphasis added).

The Government's aggregate tip estimate approach and resulting assessment based on the estimate does *not* credit the social security wage earnings history of any employee. Such arbitrary and capricious interpretations of statutory provisions that disregard the clear directive of Congress should be given no deference. *Cf.*, *United States v. Mead Corp.*, 533 U.S. 218 (2001); *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

II. THE GOVERNMENT'S ASSERTION THAT RESTAURANT EMPLOYERS MUST DISPROVE THE IRS' FICA TAX ASSESSMENT PLACES THE BURDEN ON THE WRONG PARTY AND MISUNDERSTANDS THE TIPPING PROCESS IN THE RESTAURANT INDUSTRY.

The Government argues in its brief at 7 and 12 that Respondent, Fior d'Italia, "must prove that the [IRS'] assessment is erroneous and [that Fior d'Italia] must then establish the correct amount of the tax owed." Such an approach is illogical, makes it impossible for restaurant employers to meet the burden, and virtually assures that the IRS' assessment will be conclusive in every circumstance.

The IRS' FICA tax assessment against Respondent is based on its estimate about tips that employees allegedly failed to report. However, for Fior d'Italia (or any restaurant

employer) to rebut the IRS' estimate necessitates in the first instance that Respondent (or any other restaurant employer) possess information about the unreported tips. That, however, is not the case.

As the Government admits in its brief at 2, the law requires that tipped employees report to the employer the tips they receive on a monthly basis. 26 U.S.C. 6053 (a). In turn, restaurant employers with essentially 10 or more employees must make annual reports of tips reported to them by their employees. 26 U.S.C. 6053 (c) (1) (4). However, beyond these two statutory mandates, the law requires no further involvement by the employer in the employee's tip reporting process. Congress did *not* place the burden of finding out what tips were underreported by employees on the restaurant employer. That is the IRS' job.

Furthermore, the Government's requirement that the employer disprove the IRS assessment based on its aggregate unreported tip estimate evidences a substantial misunderstanding about the tipping process in the restaurant industry. Tips are deemed to be a gratuity from the customer to the employee. The restaurant employer neither directs a customer to leave a tip nor does it determine the amount. By law, tips are considered to be the property of the employee, not the property of the employer, and are included in the gross income of the employee. 26 C.F.R. 1.451-1(c). They are *not* computed as part of a restaurant's corporate income. Indeed, under the Fair Labor Standards Act of 1938, 29 U.S.C. 201 *et seq.* (FLSA), only tips received and reported by employees that are "free of any control by the employer" may be used to meet the employer's minimum wage obligations. 29 C.F.R. 531.52. Employers are clearly not involved in the tip transaction process between the customer and the server.

Indeed, restaurant employers have no knowledge about the amount of tips each employee receives other than what each employee reports. For example, as to cash receipts, the

directly tipped employee collects the cash from the customer and then returns to the employer only an amount to cover the food and drink (and any applicable sales tax) portion of the payment. The tip amount remains in the control of the employee, and unless the tips are reported to the employer, the amount is known only by the directly tipped employee. As to credit card tips, while the employer possesses credit card receipts that show the tip amount, unless the employer institutes a tracking system to identify each server with each credit card receipt (which is not legally required and potentially could be an expensive item for restaurant employers, most of whom operate on a close profit-loss margin of 4 to 5%, *2001 [National Restaurant Association] Restaurant Industry Operations Report*), the employer does not know who received each credit card tip.

It is also important to point out that credit card receipts do not form a sufficient basis to estimate unreported cash tips. Beyond the fact, as pointed out in the majority opinion in the Court of Appeals below and recognized in the industry generally, that cash tips are usually *less* than tips left by customers on credit cards, no basis exists to guess *how much lower* cash tips normally are in comparison to credit card tips. The National Restaurant Association is not aware of any industry study that compiles such information and there is no standard industry understanding.

Finally, it is important to understand that directly tipped employees many times voluntarily share their tips with other employees. For example, employees at some 14% of all fullservice restaurants participate in tip pools. *National Restaurant Association Legislative Issues Survey*, (1999). While some tip pools are overseen by employers under strict guidelines issued by the U.S. Department of Labor under the FLSA, *U.S. Department of Labor, Wage and Hour Division Field Operations Handbook*, Vol. II at 30d04 (1988), other tip pooling arrangements are set up voluntarily by employees

and are controlled by them *outside of any involvement or knowledge* of employers. In addition, directly tipped employees many times will share or "tip out" some of their tips with other employees. Restaurant employers, however, are not involved in these arrangements and normally have little, if any, knowledge about their existence. Indeed, according to government studies, *Tip Income Study: A Study of Tipping Practices in the Foodservice Industry*, Department of Treasury, IRS, Research Div., Pub. 1530 (8-90), Catalogue No. 12482K, only about 80% of tips are retained by restaurant servers since they share or "tip-out" in excess of 20% to other employees.

It is therefore clear in the restaurant industry that restaurant employers have insufficient information about unreported tips in order to challenge or *disprove* the IRS assessment or to establish the correct amount of unreported tips received by their employees. The Government justifies imposing such an onerous burden on restaurant employers by referencing various cases discussing burden of proof about unreported income, *e.g.*, *McQuatters v. Commissioner*, 32 T.C.M. (CCH) 1122 (1973). However, these cases are not applicable to the issue before this Court since they essentially involve *two parties*: (1) the IRS and (2) the taxpayer who has the information about his or her income and yet fails to report the appropriate amount. FICA tax assessments against restaurant employers based on alleged tip income stemming from unreported tips involve a *three-party* system: (1) the IRS; (2) the tipped employee; and (3) the restaurant employer. It is the second party, the *tipped employee*, who is the party possessing the information about his or her tip income, is legally required to keep the information, 26 U.S.C. 6001, and who supposedly has failed to report it. The restaurant *employer only* has information about tips *reported* by the employee. It has no information about an employee's unreported tips, and should not bear the burden of disproving

an IRS assessment when it neither knows nor has access to the tip information upon which the assessment is based.

Consequently, to require restaurant employers, such as Fior d'Italia, to disprove the IRS' speculation about what tips were not reported unfairly places the burden on the wrong party, and virtually assures that the assessment will be conclusive in every circumstance. Such folly circumvents the wisdom of Congress that determinations about tip income be made on an *individual* basis, has no basis in law, and should be rejected. Only *after* the IRS has made an individual employee determination who failed to report what tips and the amount is an assessment for the employer's matching FICA tax appropriate.

CONCLUSION

For the foregoing reasons, the National Restaurant Association respectfully requests that the Government's request for a Writ of Certiorari be denied.

Respectfully submitted,

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